

**TENNESSEE DEPARTMENT OF REVENUE  
REVENUE RULING # 00-06**

**WARNING**

**Revenue rulings are not binding on the Department. This presentation of the ruling in a redacted form is information only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Departmental policy.**

**SUBJECT**

Application of sales and use tax to qualified subchapter S subsidiary and single member limited liability company.

**SCOPE**

Revenue rulings are statements regarding the substantive application of law and statements of procedure that affect the rights and duties of taxpayers and other members of the public. Revenue rulings are advisory in nature and are not binding on the Department.

**FACTS**

**Situation 1**

A qualified subchapter S subsidiary (“QSSS”) is a subsidiary corporation that has elected for federal purposes to have its operations taxed as a part of its parent S corporation’s (“the Taxpayer”) operations. The Taxpayer, a corporation located outside Tennessee, has made a valid QSSS election. The Taxpayer has no operations, employees, or other factors that indicate situs in Tennessee. The QSSS has property and/or operations in Tennessee and makes sales and purchases subject to Tennessee sales and use taxes.

**Situation 2**

Under certain circumstances and conditions, the so-called “check-the-box” provisions of Treas. Reg. § 301.7701-3 (1997) permit a limited liability company (“LLC”) to elect to be classified and taxed by the Internal Revenue Service as a corporation or as a partnership, or to be disregarded as an entity separate from its owner.

The Taxpayer is a corporation that owns an airplane, automobiles, machinery, and equipment. The Taxpayer will form a foreign single member LLC that will operate in Tennessee for sales and use tax purposes. The Taxpayer will then transfer the airplane, automobiles, machinery, and equipment to the LLC. The LLC elects to be disregarded as an entity separate from its owner. The Taxpayer may assign a pilot to the LLC to fly the airplane. There would be no payroll tax returns filed for the pilot since the LLC is not

recognized for federal tax purposes. The pilot, even if assigned to the LLC, would still be on the Taxpayer's payroll.

## **ISSUES**

### **Situation 1**

1. Whether Tennessee treats the QSSS as having been liquidated into the Taxpayer for sales and use tax reporting purposes.
2. If so, whether:
  - a. the transfer of motor vehicles to the QSSS from the Taxpayer is subject to sales and use tax.
  - b. the QSSS's manufacturer's authorization transfers automatically to the Taxpayer.
  - c. the 51% test applies to the sales of all the members of the Taxpayer on a combined basis.

### **Situation 2**

1. Whether the transfer of the airplane, automobiles, machinery, and equipment from the Taxpayer to the LLC is subject to sales or use tax.
2. Whether the single member LLC is a separate reporting entity for sales and use tax; and if so, whether the use of the airplane by the Taxpayer is subject to sales or use tax.
3. What the effect of the Taxpayer's assigning a pilot to the LLC is with respect to sales and use taxes.

## **RULINGS**

### **Situation 1**

1. Tennessee does not treat the QSSS as having been liquidated into the Taxpayer; the QSSS must file its own sales and use tax returns in Tennessee.
2. Tennessee does not treat the QSSS as having been liquidated into the Taxpayer, therefore:
  - a. the transfer of motor vehicles to the QSSS from the Taxpayer is subject to sales and use tax.
  - b. the QSSS's manufacturer's authorization does not transfer automatically to the Taxpayer.
  - c. the 51% test applies only to the sales of the location of the entity seeking manufacturer status.

## Situation 2

1. The transfer of the airplane, automobiles, machinery, and equipment from the Taxpayer to the LLC is not subject to sales or use tax.
2. The single member LLC is treated as a division of the Taxpayer. The use of the airplane by the Taxpayer is not subject to sales or use tax, provided that the appropriate tax was initially paid on the airplane.
3. If the Taxpayer assigns a pilot to fly the LLC's airplane, there will still be no sales or use tax liability.

## ANALYSIS

### Situation 1

1. For purposes of filing its federal income tax return, the Taxpayer is required by IRC § 1361 to disregard its QSSS as a separate corporate business entity and to include it as one of the Taxpayer's divisions.

Franchise, excise taxes are applied to all "persons" or "taxpayers," as those terms are defined in Tenn. Code Ann. § 67-4-2004(16), provided that all such entities shall be classified as such in accordance with the provisions of 26 U.S.C.A. § 7701 and the federal regulations and rulings promulgated thereunder. Tenn. Code Ann. §§ 67-4-2001<sup>1</sup> et seq. and 67-4-2101<sup>2</sup> et seq. There is no provision in the sales tax law that relies on classification of a business entity based on the federal treatment.<sup>3</sup> Accordingly, an entity doing business in Tennessee must file sales and use taxes under its own name, whether it is a QSSS or other entity. The Taxpayer is not required to register for sales and use tax in Tennessee if it has no connection with or physical presence in Tennessee.

2. Tennessee does not treat the QSSS as having been liquidated into the Taxpayer. Therefore, any transactions between the Taxpayer and the QSSS are treated as transactions between related corporations.

- a. Included in the definition of "business" are "occasional and isolated sales or transactions of aircraft, vessels, or motor vehicles between corporations or their members or stockholders and also includes such transactions caused by the merger, consolidation, or reorganization of corporations." Tenn. Code Ann. § 67-6-102(2). The Taxpayer is a stockholder of the QSSS. Accordingly, any transfer of aircraft, vessels, or motor vehicles between the Taxpayer and the QSSS is subject to sales and use tax.

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<sup>1</sup> Formerly Tenn. Code Ann. § 67-4-801.

<sup>2</sup> Formerly Tenn. Code Ann. § 67-4-901.

<sup>3</sup> In accordance with Tenn. Code Ann. §§ 48-211-101 and 67-4-2004(16), however, a business entity would be classified as the same type of business entity for sales and use tax purposes that it has been classified for federal purposes.

b. The industrial machinery authorization for manufacturers is granted to entities whose principal business is the fabrication or processing of tangible personal property for resale and consumption off the premises. Tenn. Code Ann. § 67-6-102(13)(A). An activity is the principal business if revenues generated from that activity constitute more than 50% of the total revenues generated at the specific location. *Tennessee Farmers' Coop. v. State*, 726 S.W. 2d 87 (Tenn. 1987).

The Taxpayer will be deemed a manufacturer with respect to a particular location if its principal business is the fabrication or processing of tangible personal property for resale. Tenn. Code Ann. § 67-6-206(2). Each entity wanting manufacturer status must apply to the Department. The QSSS is not deemed to have merged with the Taxpayer; therefore, the QSSS's manufacturer's authorization does not transfer automatically to the Taxpayer.

c. As stated above, manufacturer status is specific to a particular taxpayer only at those locations where more than 50% of sales are derived from the manufacture or processing of tangible personal property. The 51% test applies only to the sales of the location of the entity seeking manufacturer status. Different entities cannot combine their sales numbers to qualify for or "share" manufacturer status.

## Situation 2

The tax treatment of foreign LLCs is addressed in Tenn. Code Ann. § 48-211-101<sup>4</sup>, which provides that

For purposes of all state and local Tennessee taxes, a foreign or domestic LLC shall be treated as a partnership or an association taxable as a corporation as such classification is determined for federal income tax purposes.

A single member LLC may elect to be disregarded as an entity separate from its owner. In this situation the LLC has made that election. For state and local tax purposes, then, an LLC electing to be disregarded as a separate entity will not be treated as a separate entity, but is considered to be a part of its owner.

Under the present facts, the LLC would be treated as part of the Taxpayer, a corporation. Accordingly, the proposed transactions are not occurring between two separate entities, but within a single entity. Transactions occurring solely within a single entity are not subject to sales or use tax.

1. The transfer of the airplane, automobiles, machinery, and equipment from the Taxpayer to the LLC is not subject to sales or use tax when the LLC and the Taxpayer are classified as a single entity for federal income tax purposes.

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<sup>4</sup> A similar requirement is also found at Tenn. Code Ann. § 67-4-2004(16).

2. The single member LLC is treated as a division of the Taxpayer for purposes of all Tennessee state and local taxes. The use of the airplane by the Taxpayer is not subject to sales or use tax, provided that the appropriate tax was initially paid on the airplane.

3. If the Taxpayer assigns a pilot to fly the LLC's airplane, there will still be no sales or use tax liability, since providing an operator for an item of leased tangible personal property affects the taxability of the lease, and under the present facts, the use of the airplane by the Taxpayer is not a taxable transaction.

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APPROVED: Ruth E. Johnson  
Commissioner

DATE: 2/3/00